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BANKING & FINANCE

Filling the void for middle market construction loans

With so many active construction projects in progress in New York at any given time, one could be forgiven for thinking that financing for those properties is relatively easy to secure.

The truth, according to Robert Schwartz and Shawn Safdie of S3 Capital Partners, is that construction financing is incredibly difficult for most real estate owners and developers to find, particularly when it comes to those middle-market projects that drive growth in burgeoning neighborhoods.

"New York's construction lending market has remained a tough environment for financing," said Schwartz, who noted that conventional lenders tend to reserve a limited amount of capital for certain clients.

"This is true across all market segments, but it's especially evident among smaller balance loans – the transitional

bridge space where conventional lenders typically don't find it an efficient use of resources to monitor." It was that niche in the marketplace that inspired Schwartz and Joshua Crane – who also lead real estate investment and development firm Spruce Capital Partners – to launch S3 with finance industry veteran Safdie five years ago. The company has since funded more than 150 projects, including over \$400 million in the last 18 months.

"Early on, we saw a hole in the market for smaller-balance construction loans, and we were able to establish a structure where we can fill that gap," added Schwartz. "With our

extensive background as owners and developers, we're able to underwrite each deal from the lens of a developer, making our platform more user-friendly."

Since its inception, S3 has seen an increase in requests from clients and brokers working with conventional lenders, most of whom are tightening their belts and limiting their construction finance activity. The reasons are harder to pin down, whether concerns stem from risk, supply or simply that the books are full and the funding isn't available.

For developers, the Department of Buildings presents its own set of issues, including stop-work orders and other obstacles that can negatively affect schedules, budgets and timely repayment of loans. The slowdown in the residential real estate market is also having an impact.

"Sales and rental velocity is not at the extremely high levels that we saw even a couple of years ago – there has been an

increase in supply, and any time supply goes up there will be risk in funding new projects," said Schwartz.

"That being said, there is still a market for well-conceived, appropriately-priced properties – it's not as if there's no liquidity. The projects in trouble are the ones where investors overpaid, didn't establish the right capital structure and now have to achieve higher price points to be profitable."

S3 has funded dozens of projects throughout North Brooklyn, including Bushwick, Bedford-Stuyvesant, Williamsburg and Clinton Hill. The firm is currently seeing a lot of growth around Prospect Lefferts Gardens, Flatbush, Sunset Park and Greenwood Heights – largely a result of rising prices.

"In Prospect Lefferts Gardens and Flatbush, there's been a growth in the population of Millennials who've been priced out of Williamsburg; Greenwood Heights has become an extension of South Slope; and Sunset Park has seen a lot of action among older generations who have been priced out of other areas," said Safdie. "Developers and sponsors are driving this growth as well, as many of them have also been priced out of the more traditional neighborhoods."

In addition to its longstanding presence in Brooklyn, S3 has

been extending its geographic influence to establish stronger footholds throughout the metropolitan New York City area including Manhattan, Queens Bronx, and Jersey City.

"The revitalization of 125th Street has created a hotbed of activity in Harlem – we're doing deals for brownstone conversions in the 120s and 130s, and there's also a push for ground-up construction around 110th and 111th Streets near Lenox Avenue," said Safdie. "In Flushing – a well-established residential community – we're primarily underwriting acquisition and development deals."

Added Safdie, "Both the South Bronx and Jersey City have seen a lot of growth and new projects coming to market in recent years. These are areas where middle-market projects are fueling change, and that's exactly where we want to be."

In addition to the middle-market, where the firm has so successfully grown, it is also beginning to service clients with larger balance loans in the \$30 million to \$100 million range.

Schwartz and Safdie see significant opportunity for continued growth in this area as the construction lending market remains difficult for the majority of developers.



ROBERT SCHWARTZ